B. The Commission Should Reject ILEC Requests for Pricing Rules that Would Make Service Resale Unworkable in Practice.

ILECs do not only seek to limit the number of retail services available for resale. They also attempt to make any other opportunities for service resale uneconomic through onerous pricing theories that in some cases would even render the wholesale rate higher than the retail rate. These arguments underscore why the Commission should adopt rules to guide the negotiation and arbitration of wholesale rates. Without clear rules that are simple to administer, ILECs will be able to use their market power to prevent resale except on the most meager terms. The result would be to cramp the development of local competition across the country.

LDDS WorldCom has endorsed the principles for calculating wholesale discount levels set forth in the comments of the Telecommunications Carriers for Competition (TCC). 70/ We will not repeat that analysis here, and respond only briefly to certain arguments of the ILECs.

First: Avoided costs should include all costs attributable to retail activity. The Commission should reject the argument of many ILECs that they need not include shared, common and overhead costs when calculating wholesale discounts. 71/ ILEC retail operations incur these costs, and nothing in the Act excuses them from the avoided cost calculation. The characterizations of the costs as "common or shared" is misleading. More correctly, certain expense categories, corporate planning for instance, contain both costs that are retail related and others that are not. The problem is not that the costs themselves are common, but that the

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70/ See WorldCom at 85; TCC at 45-47. MCI demonstrates that an appropriate methodology would result in discounts for the RBOCs and GTE ranging from 33.15% to 25.63%. See MCI at 91.

71/ See, e.g., Ameritech at 80; NYNEX at 81-82; Pacific at 84.

accounting system does not separately identify which are, and which are not, related to retail activity. This imprecision in the accounting system does not justify recovering these costs in wholesale prices, it simply means that estimates will be necessary.

Second: Wholesale rates should not be set on a "net avoided cost" basis. The Commission also should reject ILEC proposals to "offset" wholesaling costs to avoided retail costs. The Act did not provide for this offset because it is so susceptible to abuse. For example, ILECs have every incentive to develop costly and inefficient wholesale infrastructures for the sole purpose of inflating the rates for wholesale services required by their competitors. Indeed, they have used this theory to argue to argue in the states that their wholesale costs exceed their retail rates. LDDS WorldCom is not suggesting that the cost of supporting carrier-to-carrier systems needed in the new environment is zero. However, these costs should be recovered in a competitively neutral manner and not used to distort the wholesale price.

Third: Wholesale prices should be established on a company-wide basis. ILECs also argue that "avoided cost" factors should be established on a service-by-service basis. The Commission should reject this recipe for delay, dispute, and discrimination, particularly here at the outset of the local competition process. At the least, the Commission should establish rules for creating a benchmark wholesale price factor for each ILEC that can be the starting point for negotiation and arbitration. This factor should be sufficient to meet the mandate that "meaningful resale opportunities are available for competition in the local exchange." 72/

72/ See H.R. Rep. No. 204, 104th Cong., 1st Sess. at 72 (1995). MCI presents a methodology for this purpose that is practical and pro-competitive. See MCI at 92-94 and Attachment 2 (J. Christopher Frentrup, "Pricing of Wholesale Services").

C. Resale Will Be Distorted Until Access Reform.

Elsewhere in these comments we have explained that one of the key differences between service resale and other forms of entry (including entry through the use of unbundled network elements) is the treatment of access charges. Under service resale, the entrant provides the retail local exchange service to the customer, while the incumbent LEC continues to provide the access to other carriers.

To the extent that access charges are priced far above cost (the situation that exists today and that will continue until the Commission concludes its universal service proceeding and permits the full implementation of Section 251), the incumbent LEC retains most (if not all) the profits from a customer, even after it has lost its retail business. In effect, this means that the reseller markets the relatively less profitable service, while the ILEC retains the cream.

The interplay between access and resale has a number of effects: it seriously undermines the viability of local service resale, it effectively negates the efficiency of an "avoided-cost" approach to the establishment of wholesale rates, and it introduces an uneconomic bias favoring facilities deployment even where such investments are uneconomic. This final point bears demonstrating because of the repeated, yet inaccurate, claim of some local entrants that resale will lessen carrier incentives to construct facilities.

Time Warner's comments, for example, include a comparison of estimated operating margins for a "facilities-based" entrant and a reseller under various wholesale discounts ranging from 40% to 10%. 73/ Time Warner claims that its comparison shows that resale margins exceed those of a facilities-based carrier,

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73/ Time Warner at 70-72 and Attachment 4.

even where the wholesale rate is set at 90% of the retail rate. 74/ Time Warner's analysis, however, is both flawed and misleading, because it ignores the access revenues that accrue to the facilities-based carrier, but which are retained by the ILEC with service resale. 75/ When even average access charges are considered, Time Warner's conclusions are reversed: the facilities-based margin increases from \$3.22 to approximately \$17.00 per line, 76/ far greater than even its largest estimated resale margin of \$9.20. 77/

The fact is that no matter how diligently the Commission removes retail-related costs from the ILEC's wholesale prices, the above-cost pricing of access will distort the reseller's ability to compete. As the Department of Justice noted

> The economics of a competitive [local] marketplace would not support entry solely on the revenues derived from local exchange service. Department of Justice at 39.

Similarly, local competition based on the resale of wholesale services will not succeed so long as the access charges which the local exchange carrier continues to receive from the reseller's customers are the principal source of local profit.

74/ Id. at 71.

75/ The flaw in Time Warner's analysis goes far beyond the *omission* of access revenues. Time Warner also includes as a "cost" of facilities-based entry the "lost access revenues" that are retained by an ILEC under some interim number portability schemes. In other words, even though Time Warner fails to include the access revenues that it *would receive*, it views as a cost the access revenues that it *does not*.

76/ The comparison is presented for a business customer, correcting Time Warner's analysis to include 1994 average switched access revenues of approximately \$11.00 per month and removing "lost access revenues" as a cost of interim number portability. As Time Warner itself recommends, the Commission should clarify that the carrier terminating the end user's traffic should receive the terminating access revenue.

77/ This comparison accepts as valid the remainder of Time Warner's analysis. Time Warner certainly understands the importance of access revenues to its business plan, however, and their omission raises questions regarding its other assumptions. Nevertheless, for the purposes here, no additional review of its methodology has been attempted.

CONCLUSION

LDDS WorldCom has not addressed many other critical issues raised in this proceeding. Again, we refer the Commission to the comments of the TCC and its member companies on other points.

We also reemphasize a point raised in our initial comments. The Commission must recognize expressly in its decision here that it will be revisiting its local competition rules as the industry gains experience trying to work with the revolutionary changes wrought by Sections 251 and 252. It is inevitable that the Commission will find that some rules are insufficient, others unnecessary, and still others must be added based on developments that cannot be foreseen today.

The Commission will make a good start to fulfilling the mandates of the Act if it always keeps in mind the difficulty that requesting carriers face in obtaining use of the ILEC network -- especially given the ILEC's lack of market incentives to cooperate in that process. ILEC bargaining power is a dark cloud over the future of local competition that must somehow pass.

Respectfully submitted,

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